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JUNE 6, 2002 PUBLIC MEETING OF THE COMMODITY FUTURES TRADING COMMISSION REGARDING THE STUDY OF POTENTIAL CHANGES IN THE REGULATION OF INTERMEDIARIES PURSUANT TO SECTION 125 OF THE COMMODITY FUTURES MODERNIZATION ACT OF 2000

My name is Steven Olgin and I am the Chief Administrative Officer of MLIM Alternative Strategies LLC, an affiliate of Merrill Lynch & Co., Inc. which acts as a sponsor of managed futures and hedge fund investment products. MLIM Alternative Strategies LLC and its predecessor entity have been registered with the CFTC as a commodity pool operator and commodity trading advisor and a member of the National Futures Association since 1986. MLIM Alternative Strategies LLC is also registered with the Securities and Exchange Commission as an investment adviser and transfer agent. MLIM Alternative Strategies LLC has sponsored over 75 different investment vehicles, both publicly and privately offered to United States and non–U.S. investors.

I greatly appreciate the opportunity to appear before the Commission to assist in its study of potential changes in the regulation of intermediaries pursuant to Section 125 of The Commodity Futures Modernization Act of 2000 (the "CFMA"). My remarks today will focus on regulatory issues affecting commodity pool operators and commodity trading advisors offering managed futures and hedge fund investment products. Specifically, I will discuss — as contemplated by the CFMA itself in mandating this study — several areas of commodity pool

regulation which the Act did not address and which could be simply changed, which would not only rationalize the regulation of commodity pools with other investment products, but also harmonize the various overlapping bodies of regulatory jurisdictions applicable to commodity pools – a legislative policy objective expressly approved by both the National Securities Market Improvement Act of 1996 ("NSMIA") and the CFMA.

Commodity pools seek to provide a wide range of investors with an investment opportunity that is not highly correlated with more traditional stock and bond investments through a vehicle which offers limited liability, daily valuations and far greater liquidity than most alternative investment products. Commodity pools also provide much needed liquidity to certain futures markets (in particular, the agricultural markets), increasing the efficiency of the price discovery and hedging functions served by these markets. However, over the past 10 years the number of publicly offered commodity pools available to U.S. persons has been significantly reduced due, in large part, to the enormously high entry barriers created by five overlapping regulatory jurisdictions — the CFTC, the NFA, the SEC, the NASD, and the States.

I will discuss seven different suggestions in connection with the study mandated by the CFMA.

1. Requirement of Delivery of a Disclosure Document Prior to Any "Direct or Indirect Solicitation"

Commodity pools are the only investment product, or security for that matter, for which it is required that a complete disclosure document be delivered to prospective investors prior to any "direct or indirect solicitation". Rather than inquiring of prospective investors whether they are sufficiently interested to want to receive a prospectus, commodity pool sponsors must first send a prospectus prior to even ascertaining the investor's actual interest in

this investment product. This requirement imposes a unique and costly burden on this one form of investment without adding significantly to investor protection. Of course, no one should be permitted to invest until they have received a complete disclosure document. However, by requiring that the disclosure document be delivered before even an indication of interest can be ascertained, commodity pools, which generally bear such ongoing offering expenses, are subject to costs significantly greater than other pooled investment products subject to different regulatory regimes.

In addition, the need to deliver a disclosure document before any "direct or indirect solicitation" prohibits "tombstone" type advertisements that contain a limited amount of straightforward factual information about the offering by CTAs and CPOs that are otherwise permissible under the federal securities laws. Under existing law, any advertisement on its face is at least an indirect solicitation.

I would recommend that the CFTC consider amending the CEA to adopt the approach applied by the SEC to registered investment advisers ("RIAs") – requiring the delivery of their disclosure document at least 48 hours prior to entering into an actual agreement with the client, not prior to any "direct or indirect solicitation." The "manner of offering" and prospectus delivery requirements imposed by the securities laws designed to prevent the improper dissemination of securities-related advertisements are as sufficient in the case of CPOs and CTAs, as in the case of RIAs. This would be one step forward in harmonizing the securities and commodities regulation to impose the same requirements on CTAs as on RIAs.

2. SEC Deference to CFTC in the Review of Public Pools

Currently, public commodity pools must submit and have their prospectuses cleared by both the SEC and the CFTC, as well as filed in all 50 States (a large number of which still conduct extensive reviews). The SEC in its review applies the general provisions of Regulation S-K (the basic SEC disclosure rule). However, as one would expect, many of these provisions are almost wholly irrelevant to a commodity pool. As a result, there have been years of negotiations between the industry and the staff of the SEC concerning how to modify Regulation S-K to fit the disclosure needs particular to commodity pools. The irony is that the CFTC has promulgated and spent years developing and refining disclosure rules specifically created for publicly-offered commodity pools — devoting, for example, detailed analysis regarding the treatment of performance information, the importance of trading principals, the "portability" of performance records, etc...: issues which are of material and immediate importance to commodity pool disclosures but almost wholly irrelevant to the disclosures relating to operating companies to which Regulation S-K is directed. Although the most recent extensive revision of the CFTC's Part 4 Rules was in 1995, the CFTC's updating and review of its disclosure rules is an ongoing process and the CFTC is well-attuned to the disclosure issues which arise in the industry.

The SEC staff has many other important demands on its time. As it is, the efforts that the CFTC has put into refining the commodity pool disclosures are largely abrogated due to the need of the pools to conform to Regulation S-K. In fact, in some instances, combining the SEC's and the CFTC's regulations are not only burdensome, but also counterproductive from a disclosure perspective. For example, the SEC requires that public offering prospectuses include a section on Quantitative and Qualitative Disclosure About Market Risk. The purpose of this

requirement is to force operating companies to disclose the contingent risk in their open derivatives positions incidental to their main line of business. However, in the context of a pool, whose only business is trading in derivatives positions, the Regulation S-K disclosures are not only redundant, but potentially misleading.

I would recommend that Congress consider amending the 1933 Act to provide that securities issued by commodity pools be subject to review by a single regulator, rather than the disparate and overlapping SEC, CFTC and State standards that currently apply. Congress took similar action when it enacted NSMIA, which preempted substantive reviews of mutual fund prospectuses by the states in order to ensure that mutual fund sponsors would be subject to a single regulator, the SEC, rather than a multiplicity of reviewers. Similar action regarding commodity pools would not only improve the quality of the commodity pool disclosures but also conserve valuable resources at regulators other than the CFTC that are better directed towards products not otherwise expressly regulated by another agency expert in the matter.

3. Pools Should Be Exempt From 1934 Act Reporting

Inconsistent regulations also exist in connection with the requirement that publicly-offered commodity pools file standard 1934 Act reports (10-Qs, 10-Ks, etc.). The reports are also governed by Regulation S-K and result in the same confusing disclosures, as does the application of S-K to public offering documents of commodity pools. Investment companies are expressly exempted from 1934 Act reporting precisely because the Investment Company Act of 1940 has its own reporting system. The CEA and the Part 4 Regulation impose on commodity pools reporting requirements that were specifically designed for these types of investment products and, in fact, require more frequent reporting (monthly rather than quarterly) than required under the 1934 Act.

4. State Deference to the Federal Regulation

Commodity pools are one of the few investment products which remain subject to substantive regulation by the States. Not only do the States impose material substantive restrictions on the structuring of publicly-offered commodity pools but also the sheer administrative burden of having to file with each State — and negotiate with the administrators in each of the merit review States — is and has for years been criticized as one of the primary entry barriers to the offering of public commodity pools. The debate concerning the proper role of the States in reviewing commodity pool filings has been ongoing for at least the last two decades. The state regulation of commodity pool offerings seems directly contrary to the federal preemption of the States in the regulation of futures trading itself, as well as to the federal preemption of the States over investment company regulation established by NSMIA. The commodity pool is no longer in its infancy; and the status of its regulation should reflect that fact.

Publicly-offered commodity pools which have been cleared by the CFTC should be subject to notice filings but no substantive review at the State level. A resurgence of the domestic commodity pool industry would be significantly enhanced with the elimination of the entry barrier of State regulation .

5. "Private" Commodity Pool Operators Should be Exempt From Registration

For at least two decades, there has been a disconnect between SEC and CFTC regulations in that the former provided that a manager could privately advise up to 15 funds without need of registering as an "investment adviser," whereas the CFTC took the position that

managing any fund (even a private pool) was "holding oneself out to the public" as a CPO which required CPO registration.

There is no justification for this distinction and it has caused a generation of discontent among hedge fund managers. These managers, even though their trading is overwhelmingly securities-based, have been required to register with and be audited by the CFTC simply because they would occasionally use an S&P futures as a hedge. The principal regulator, the SEC, was on record as taking the position that there was no need to regulate the persons who limited their advice to a limited number of sophisticated hedge fund investors. The CFTC jurisdiction was very much the tail wagging the dog.

I would recommend that a new exemption from CPO registration be created for CPOs of pools offered and sold only to sophisticated persons in private transactions exempt from registration under the 1933 Act unless they manage 15 or more funds, or hold themselves out to the public as commodity pool operators. At a minimum, this would be appropriate for those managers which are engaged primarily in securities trading, not hedge funds futures trading (a distinction which the CFTC is well used to under its Rules 4.5 and 4.12(b)). These managers are properly the purview of the SEC, not the CFTC.

6. Conform the CPO Exemption from Investment Adviser Registration to that Available to CTAs

The CFMA provided that registered CTAs which primarily trade futures need not register as investment advisers and *vice versa*. However, the same exemption was not extended to CPOs. This is particularly ironic because CTAs manage unlimited liability managed accounts whereas CPOs sponsor limited liquidity collective investment vehicles. Given the high degree of leverage used in most futures trading, it is clearly imprudent to steer investors towards managed

accounts as opposed to pools, but that will be the inevitable effect of failing to include CPOs within the scope of the CFMA's "primarily engaged" exemption from investment adviser registration. No purpose is served by this distinction.

7. Adoption of Two Uniform Standards For Certain Categories of Commodity Pool Investors

Over the course of years, the SEC and CFTC have engaged in an effort to expand and clarify those groups of persons to which certain provisions of the Investment Company Act, Commodity Exchange Act, Securities Act of 1933, Investment Advisers Act and other laws had no need to apply. However, as a result of the separate paths taken by the agencies and the ad-hoc method in which they produced their criteria for the "qualified investor," we are left with a crazy quilt of largely, but <u>not</u> completely, overlapping investor qualification standards. Currently, we have Accredited Investors, Qualified Institutional Buyers, Eligible Contract Participants, Qualified Clients, Qualified Eligible Persons and Qualified Purchasers.

I would recommend that Congress adopt the Accredited Investor standard as a disclosure-oriented standard defining persons exempt from specific regulatory disclosure requirements and to whom manner of offering restrictions do not apply; and the CFTC Qualified Eligible Person standard as a substantive standard defining persons who can fend for themselves and, accordingly, are exempt from Investment Company Act numerical limitations able to deal in derivative markets. Two uniform standards would represent a major conceptual improvement over the current array of different standards and regulatory requirements.

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Thank you very much for your time. We welcome this study as an excellent opportunity to eliminate some of the historical artifacts of commodity pool regulation, which for years have put industry members and US investors at a distinct disadvantage. By leveling the playing field, we can both help US investors by reducing entry barriers and administrative costs and by conserving the regulators' limited resources.